

ILLINOIS REGISTER

DEPARTMENT OF REVENUE

NOTICE OF PROPOSED AMENDMENT

- 1) Heading of the Part: Retailers' Occupation Tax
- 2) Code Citation: 86 Ill. Adm. Code 130
- 3)

<u>Section Numbers:</u>	<u>Proposed Action:</u>
130.2165	Amendment
- 4) Statutory Authority: 35 ILCS 110/12; 5 ILCS 2505/2505-795
- 5) A Complete Description of the Subjects and Issues Involved: This rulemaking clarifies the types of tax liabilities that may be incurred by veterinarians, including liability under the Service Occupation Tax Act, the Use Tax Act and the Retailers' Occupation Tax Act. The rulemaking sets forth the requirements that must be met in order for a transaction to be considered a service transaction, including the existence of a Veterinarian-client-patient relationship ("VCPR"), physical examination of the animal and maintenance of proper books and records documenting the VCPR. The regulation describes the circumstances under which service transactions occur. These include instances when medicines, drugs or other products are directly applied or administered by a licensed veterinarian during a veterinary examination, or when medicines, drugs or other products having a medicinal purpose are sold by a licensed veterinarian as part of a continuing plan for the health and well being of an animal under his or her care. The regulation defines "medicinal purpose" and also details the books and records that must be kept in order to document the occurrence of a service transaction. Examples are provided of items that have a medicinal purpose, and of several types of service transactions. The regulation also provides a brief explanation (with cross-references to the Service Occupation Tax regulations in Part 140) of the manner in which tax may apply to those transactions. The regulation similarly defines and provides examples of transactions that constitute sales subject to the Retailers' Occupation Tax and Use Tax Act.
- 6) Published studies or reports, and sources of underlying data, used to compose this rulemaking: None
- 7) Will this proposed rule replace an emergency rule currently in effect? No
- 8) Does this rulemaking contain an automatic repeal date? No
- 9) Does this proposed rule contain incorporations by reference? No
- 10) Are there any other proposed rule(s) pending on this Part: No
- 11) Statement of Statewide Policy Objectives: This rulemaking does not create a State mandate, nor does it modify any existing State mandates.

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- 12) Time, Place and Manner in which interested persons may comment on this proposed rulemaking: Persons who wish to submit comments on this proposed rule may submit them in writing by no later than 45 days after publication of this notice to:

Jerilynn Troxell Gorden
Deputy General Counsel, Sales & Excise Tax
Illinois Department of Revenue
Legal Services Office
101 West Jefferson
Springfield, Illinois 62794

(217) 782-2844

- 13) Initial Regulatory Flexibility Analysis:

- A) Types of small businesses, small municipalities and not for profit corporations affected:
Veterinary practices
- B) Reporting, bookkeeping or other procedures required for compliance: General
Bookkeeping
- C) Types of Professional skills necessary for compliance: General Bookkeeping

- 14) Regulatory Agenda on which this rulemaking was summarized: July 2007

The full text of the Proposed Amendment begins on the next page:

SUBPART S: SPECIFIC APPLICATIONS

Section 130.2165 Veterinarians

- a) Veterinarians as servicemen ~~When Liable For Tax~~

Veterinarians are engaged primarily in rendering service to their clients and so are considered to be servicemen. As medical professionals regulated under the Veterinary Medicine and Surgery Practice Act of 2004 ("the Act"), 225 ILCS 115/1 et seq., they typically provide services to persons with whom they have established a "Veterinarian-client-patient relationship ("VCPR")" as defined in Section 3 of the Act. Under the Act, in order to maintain a valid VCPR, a veterinarian must maintain sufficient knowledge of the animal to initiate treatment and be readily available for follow-up. In addition, he

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must maintain adequate medical records, as provided in regulations adopted under the Act at 68 Ill. Adm. Code 1500.50 (a)(11), and must comply with certification, licensure, professional conduct and disciplinary requirements, including continuing education mandates, as provided for by the Act and regulations promulgated thereunder. Services provided by veterinarians are predicated upon compliance with these requirements.

~~When veterinarians sell items of tangible personal property, such as pet food, animal tags, pet collars, leashes, and the like, other than farm chemicals (see Section 130.1955 of this Part) to purchasers for use or consumption apart from their rendering of service as veterinarians, they incur Retailers' Occupation Tax liability. Veterinarians who sell items over the counter must be registered as retailers. (See Subpart G of this Part.) Any item sold to a veterinarian who intends to resell the item shall be taxable unless the veterinarian provides the seller with a Certificate of Resale.~~

b) Tax liabilities of veterinarians~~When Not Liable for Tax~~

In conducting a veterinary practice, veterinarians may incur different types of tax depending upon the nature of their activities. When licensed veterinarians transfer tangible personal property to their clients as a result of the practice of veterinary medicine, a service transaction occurs that results in liability under the Service Occupation Tax Act. Veterinarians also sometimes sell items of tangible personal property to clients or even to the general public outside the scope of a service transaction. In such cases, they are considered to be retailers engaged in the business of selling tangible personal property at retail and incur Retailers' Occupation Tax liability. In addition, veterinarians incur Use Tax on items of tangible personal property that are not transferred to their clients and instead are consumed by them in the course of performing veterinary services. The following sections describe the requirements for a "service transaction" and define the tax liability that results from these transactions. Also described are the circumstances under which Retailers' Occupation Tax liability and Use Tax liability are incurred by veterinarians.

~~Veterinarians are engaged in a profession and primarily render service. To the extent to which they engage in such profession, they are not engaged in the business of selling tangible personal property to purchasers for use or consumption within the meaning of the Act. Consequently, they are not required to remit Retailers' Occupation Tax measured by their receipts from engaging in such profession, including receipts from both services and tangible personal property transferred incident to those services.~~

c) Service Transactions – Requirements – Taxation~~Example~~

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- 1) In order for a transaction to be considered a service transaction for purposes of taxation, several requirements must first be met. Specifically:
 - A) A licensed veterinarian must have first established a valid VCPR with the service client as defined in Section 3 of the Act;
 - B) A licensed veterinarian must have physically examined the animal;
 - C) A veterinary practice must maintain medical records demonstrating that the animal for whom tangible personal property was transferred was physically examined by a licensed veterinarian in that veterinary practice no more than 1 year prior to the date on which tangible personal property was transferred;
 - D) The requirements of this subsection (c) (1) are not intended in any way to affect the requirements of the Veterinary Medicine and Surgery Practice Act of 2004 concerning the establishment or maintenance of a valid VCPR. The requirements of this subsection (c)(1) are intended only to establish the type of tax liability that will be incurred by a veterinary practice.
- 2) When veterinarians engage in service transactions, they incur liability under the Service Occupation Tax Act. See 86 Ill. Adm. Code Part 140 for a detailed explanation of these liabilities. Assuming a valid VCPR has first been established, a service transaction occurs under the following circumstances:
 - A) A service transaction occurs when medicines, drugs and other products are directly applied or administered by a licensed veterinarian during a veterinary examination. Tangible personal property transferred may include, but is not limited to, vaccines; flea and tick products; shampoos; bandages; ointments; splints and sutures.
 - B) A service transaction occurs when a licensed veterinarian sells medicines, drugs, and other products having a medicinal purpose, as defined in subsection (c)(2)(C) of this Section, as part of a continuing plan for the health and well being of an animal under his or her care. These drugs, medicines and other medicinal products may be products that Federal law restricts to use only by prescription from a licensed veterinarian, or may be products which are recommended by the veterinarian under a continuing plan for the health and well being of the animal. These transactions include refills of such drugs, medicines and other medicinal products that are made "over-the-counter" without a physical examination

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of the animal on the date of the refill. In order to document that qualifying items are transferred as part of a continuing plan for the health and well being of the animal, the following requirements must be met:

- (i) the licensed veterinarian transferring items to the service client (or the veterinarian's designee) must enter a notation in the animal's medical records that such medicine, drug or medicinal product was recommended or prescribed as a result of an examination or after consultation with the service client; and
- (ii) the licensed veterinarian transferring items to the service customer (or the veterinarian's designee) must sign and contemporaneously date the notation in the animal's medical records; and
- (iii) the animal's medical records must demonstrate that a licensed veterinarian in the veterinary practice that transferred the items to the animal examined the animal no more than 1 year prior to the date on which the items were transferred.

- C) For purposes of this subsection (c), a medicine, drug, or other product having a medicinal purpose means items that are ingested by or applied to an animal and which cure or treat disease, illness, injury, or pain or mitigate the symptoms of such disease, illness, injury or pain. Such items may include, but are not limited to, items that are required to be prescribed by a veterinarian; nonprescription medicines; vitamins, herbal remedies and dietary and nutritional supplements (e.g., glucosamine chondroitin); medicated shampoos; topical flea and tick products applied directly on an animal for the control of fleas and ticks; and flea and tick collars. Such items also include dental products such as toothpaste, toothbrushes, and chews that are specifically designed to promote dental health in animals; insecticides and insect growth regulators that are applied by broadcast treatment (e.g. hand pump sprayers or pressurized aerosols) or with total release aerosols or foggers; products used to treat urinary behavior issues; collars worn by an animal after surgery to prevent the removal of sutures; and splints and braces. Animal food is considered to have a medicinal purpose only if its manufacturer restricts its sale to licensed veterinarians. In order to document the requirement that the manufacturer restricts the sale of animal food to licensed veterinarians, a veterinarian shall annually obtain a letter from the manufacturer representing that the animal food is sold only to licensed veterinarians. Provided that a veterinarian maintains this letter in his or her books and records, the Department shall consider the animal food to have a "medicinal purpose"

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for the period of one year following the date of issuance of the letter. The following items are not considered to have medicinal purposes: combs; brushes; shears; nail clippers; name tags; nonmedicated shampoo; leashes; collars; toys; clothing; odor eliminators; and waste handling products. Prescriptions for animals are subject to the high rate of tax. See, 86 Ill. Adm. Code 130.310.

EXAMPLE 1: During a veterinary examination of a dog, a veterinarian breaks open a 6 dose package of flea and tick product, and applies one packet to the dog. She recommends that the service client continue use of the flea and tick product, and offers the remaining 5 packets for sale. If the customer purchases all 5 packets of the flea and tick product at the time of the service transaction, the veterinarian will incur liability under the Service Occupation Tax on the 6 pack of flea and tick product (one applied to the animal incident to service, the other 5 transferred to the service customer as part of the service transaction). If the service customer returns 6 months later and purchases 2 additional flea and tick packets without examination of the dog, the veterinarian will incur liability under the Service Occupation Tax provided that he maintains the proper documentation in his books and records as required in subsection (c)(2)(B) of this Section.

EXAMPLE 2: A service client discovers that her dog has fleas, so she takes it to her veterinarian for treatment. The veterinarian uses a lice comb to examine for fleas and then applies a nonprescription flea and tick bath to treat the infestation. She recommends that the service client purchase additional bottles of the product to ensure that treatment is complete. The service client returns 2 weeks later to purchase an additional bottle of product. The veterinarian will incur liability under the Service Occupation Tax on the flea and tick product she transferred when treating the dog, as well as on the subsequent sale of the same flea and tick product (provided that the required documentation is maintained). The veterinarian will incur Use Tax on the flea and tick comb that she uses in her practice (as well as other items used or consumed in the grooming and bathing of the dog, such as towels, dryers or disposable pads).

3) Application of Service Tax to Example

- A) In both Examples 1 and 2 of subsection (c)(2)(C) above, the veterinarian can remit Service Occupation Tax based on her selling price of the tangible personal property transferred incident to service, as more fully explained in subsection (c)(3) (B) of this Section. However, if her annual

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aggregate cost price of all items transferred incident to service transactions is less than 35% of her annual aggregate gross receipts from service, she may elect instead to handle her liability by being treated as a “de minimis” serviceman. See 86 Ill. Adm. Code 140.106 for an explanation of the 35% threshold. As a de minimis serviceman, she may pay tax as follows:

i) If she does not make over-the-counter sales subject to Retailers’ Occupation Tax (e.g., sales of leashes, clippers or combs), she may elect to remit **Use Tax** to her suppliers on her cost price of tangible personal property transferred incident to service (if her suppliers are not registered to collect the Use Tax, she must register for the limited purpose of self-assessing and remitting Use Tax on these purchases). See 86 Ill. Adm. Code 140.108 for further information. She cannot provide Certificates of Resale to her suppliers if she elects this option.

ii) If she makes over-the-counter sales subject to Retailers’ Occupation Tax, she may remit **Service Occupation Tax** to the Department on the cost price of the tangible personal property she transfers incident to service. See 86 Ill. Adm. Code 140.109 for further information. In this case, she should provide Certificates of Resale to her suppliers. She must register and file returns with payment of tax to the Department.

B) If the veterinarian’s annual aggregate cost price of all items transferred incident to service transactions is 35% or more of her annual aggregate gross receipts from service, she cannot elect to be treated as a “de minimis” serviceman. She must pay **Service Occupation Tax** on the selling price of the tangible personal property transferred incident to service. See, 86 Ill. Adm. Code 140.106. She must register and remit returns with tax to the Department. She should provide Certificates of Resale to her suppliers and may calculate her selling price as follows:

i) Separately stated selling price. If the serviceman separately states the selling price of the tangible personal property transferred incident to service on billings to service customers, then her Service Occupation Tax liability is based on that separately stated selling price. In no event, however, can the Service Occupation Tax liability be based on an amount less than the serviceman’s cost price of the tangible personal property being transferred.

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- ii) Fifty percent base. If the serviceman's bill to the service customer does not separately state the selling price of the tangible personal property transferred, the serviceman's Service Occupation Tax liability is based on 50% of the entire customer bill. However, in no event can the Service Occupation Tax be based on an amount less than the serviceman's cost price of the tangible personal property being transferred.

~~For example, if a veterinarian sells a pet diet product that is also available over the counter at pet supply retail outlets, the veterinarian incurs a Retailers' Occupation Tax liability on such sales. However, if a veterinarian transfers a pet diet product that is available only through prescription by a veterinarian and is not available over the counter, such transfer is subject to Service Occupation Tax liability.~~

d) Retail Transactions – Defined – Taxation

- 1) Retailers' Occupation Tax Liability will be incurred by veterinarians in the following circumstances:
 - A) Retailers' Occupation Tax liability will be incurred on the sale of any tangible personal property to persons with whom the veterinarian has not established a valid VCPR in accordance with the Veterinary Medicine and Surgery Practice Act of 2004. Such items may be medicinal (e.g., a flea and tick product for application on an animal) or non-medicinal (e.g., nonmedicated shampoos, combs, leashes, collars).
 - B) Retailers' Occupation Tax liability will be incurred on the sale of any tangible personal property to persons with whom a veterinarian has established a valid Veterinarian-Client Patient Relationship ("VCPR") if those items are sold outside the scope of the service transactions described in subsection (c) above. The following items are considered to be transferred outside of the scope of a service transaction, regardless of whether a VCPR has been established: combs, brushes, shears, nail clippers, name tags, nonmedicated shampoos, leashes, collars, toys, clothing, odor eliminators, and waste handling products.

e) Use Tax Incurred by Veterinarians

A veterinarian will incur Use Tax on tangible personal property that he uses or consumes in his veterinary practice and which is not transferred to a service customer. In Example 2 of subsection (c)(2)(C) above, such items would include the disposable pads, dryers, combs and towels. Other items might include, but are not limited to,

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cleaning supplies, tables or chairs, thermometers and hand soap. Certificates of Resale cannot be used for the purchase of these items. Instead, Use Tax must either be paid to suppliers or if suppliers are not registered to collect tax, then the veterinarian must self-assess and remit Use Tax to the Department.

(Source: Amended at 32 Ill. Reg. _____, effective _____)